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C O N F I D E N T I A L SECTION 01 OF 04 ANKARA 000761

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TAGS: [ECON](#) [ENRG](#) [IZ](#) [PGOV](#) [TU](#)
SUBJECT: SCENESETTER FOR SPECIAL ENVOY MORNINGSTAR: THIRD
US-TURKEY ENERGY WORKING GROUP

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[1](#)B. BRUSSELS 732

Classified By: CDA Douglas Silliman for reasons 1.4(b,d)

[1](#)1. (SBU) Summary: From the Baku-Tbilisi-Ceyhan oil pipeline negotiations in the 1990s until today, Turkey and the U.S. have shared a strategic vision to bring new oil and gas resources to market through new routes. Opening an East-West Corridor for gas would strengthen the ties of Central Asia and the Caucasus with the West and decrease the dependence of eastern and central European countries on a single gas source. Over the past two years, we have also seen Turkey articulate another vision that is sometimes at odds with our shared one: to secure increased gas supply to Turkey's domestic market as its highest priority. Whether to meet growing internal gas demand, to reduce the average gas price in Turkey, or to create some type of energy hub infrastructure, Turkey has made clear its own needs for gas come first. With the May 2 appointment of a new Energy Minister, Taner Yildiz, Turkey has experienced a breakthrough in negotiations with Azerbaijan (reftel A) and Russia for additional gas supply. By contrast, negotiations with Nabucco partners appear to have taken a turn for the worse (reftel B). Yildiz has difficult decisions to make. Agreements to import new gas from Azerbaijan, Russia and Iraq pit three interest groups against each other: free market advocates (and international oil companies); friends of the PM; and interests connected to maintaining the monopoly of the state-owned oil and gas pipeline company BOTAS. Perhaps trying to make a decision that gives something to everyone, Yildiz is asking the negotiators for more time.

[1](#)2. (SBU) Your visit is an important opportunity to remind the GOT that win-win solutions are possible. A policy that positions Turkey at the heart of an East-West energy corridor will inevitably pull more resources to Turkey as well as Europe. With the transit of increased gas resources, Turkey can strengthen its own relationship with Azerbaijan, Turkmenistan, Iraq and the EU. Additionally, with market liberalization, Turkey can drive down the domestic price for gas. You should also raise the possibility that driving too hard a bargain and hoarding the new gas coming out of the Caspian and Iraq can create a lose-lose situation for Turkey. International oil companies may choose routes other than through Turkey, and supplier countries could also chose to leave their resources in the ground. Turkey does not appear to believe that either of these situations could come to pass. End summary.

[1](#)3. (SBU) The third U.S.-Turkey Energy Working Group scheduled for June 4 in Ankara will be led by MFA Deputy Undersecretary Selim Kuneralp and will include high-level representatives from the Ministry of Energy, Turkish Petroleum Company (TPAO) and BOTAS (state-owned pipeline company). You will have a separate follow-on meeting with Energy Minister Yildiz.

Points to Raise

¶4. (SBU) Recommend highlighting:

-- Following Yildiz's May 13-14 trip to Baku, Turkey and Azerbaijan appear close to concluding an agreement to (1) raise the sales price of Shah Deniz Phase I gas to Turkey and (2) sell up to 8 bcm of Shah Deniz Phase II gas to Turkey for domestic consumption. Urge Turkey to complete these agreements as soon as possible. (para 8)

-- Urge Turkey to take steps immediately to open the East-West energy corridor. Allowing Iraq as an entry point for Nabucco is one important step. Another step is to sign the Nabucco IGA in late June. (para 10, 11)

-- Express concern about Blue Stream II. (para 12)

-- Urge Turkey to work with the U.S. for the passage of hydrocarbon/revenue sharing laws in Baghdad. Explain broadly the possibilities for gas development and urge Turkey not to pursue zero-sum game policies. (para 13)

Likely Turkish Concerns

¶5. (SBU) The Turkish side could raise:

-- Azerbaijan has not decided to whom it will enter into a purchase and sales agreement for Shah Deniz II gas. What is the U.S. position if Azerbaijan sells its gas to (a) Turkey-Greece-Italy (TGI), thereby undermining the viability

ANKARA 00000761 002 OF 004

of Nabucco or (b) Russia? (para 9)

-- With companies like Norway's DNO and Turkey's Genel Enerji obtaining permission to export oil from the KRG region without the passage of the federal hydrocarbons law, why shouldn't we pursue deals now to avoid being left out of important opportunities? (para 14)

-- What are the next steps for the TDA MOU? In addition to TDA, will there be other U.S. initiatives to support Turkey's energy efficiency or renewable energy sectors? (para 15)

-- We are concerned about the announcement made by U.S. Ambassador to Cyprus Frank Urbancic that a U.S. firm will soon begin exploring for oil and gas off the coast of Cyprus in disputed waters (para 16)

Energy as seen through politics

¶6. (SBU) Despite free give-aways ranging from coal to household appliances, the ruling party's support declined in March 2009 local elections to 38% of the vote, down from 47% in the national parliamentary elections of July 2007. Stung by the election results, PM Erdogan said the AKP has taken a lesson from the voters. AKP is looking to strengthen its showing in the 2011 parliamentary elections and the PM is rumored to want to run for the Presidency in the first-ever popular election of a Turkish president. In that context, AKP will be looking to show voters favorable results. For energy, this means being able to deliver more resources at lower costs. Before the onset of the global economic crisis, Turkey's annual economic growth rate averaged 6% with an accompanying growth rate in energy usage of 8% annually. Many analysts expect economic growth will begin to revive in 2010 and the energy sector will lead that growth.

¶7. (C) Turkey's movement to normalize relations with Armenia provoked outrage in Baku and considerable political pressure on the AKP by the opposition, which claimed Turkey had abandoned its brother, Azerbaijan. This political dynamic will continue to play into energy politics. The PM's May

13-14 visit to Baku seems to have eased tensions with Azerbaijan but complicated efforts to open relations with Armenia. Turkey should use this opening to strengthen and deepen economic ties with Azerbaijan by concluding long-stalelated negotiations to raise prices for the gas currently being sold to Turkey (Shah Deniz Phase I) and for future supplies (Shah Deniz Phase II). Such an agreement could ease Azerbaijani concerns about Turkey and increase Turkey,s flexibility vis-a-vis Azerbaijan to normalize relations with Armenia, but is difficult for two reasons. First, higher prices for Azeri gas will inevitably mean that the average price for gas in Turkey will increase -- unless Turkey can negotiate lower price contracts with other suppliers. Second, Azerbaijan's condition for selling gas to Turkey is that its own company, SOCAR, be allowed to directly enter the Turkish market. Currently, gas is imported almost exclusively by the state-owned pipeline company, BOTAS.

Transit Negotiations with Azerbaijan

18. (SBU) Turkey and Azerbaijan appear to have come closer than any time in the last 18 months to reaching agreement on all outstanding issues. Turkey needs to turn agreements in principle with Azerbaijan into concrete, signed agreements to justify the large private sector investments required in upstream and midstream infrastructure to open the East-West energy corridor. According to reftel A,Turkey and Azerbaijan reached an oral agreement that Azeri gas could transit Turkey to Europe and that Azerbaijan will choose the project to which it sells its gas. The two sides also came close to resolving a year-long price dispute related to Shah Deniz Phase I gas currently being sold to Turkey. Additionally, the two sides made progress in defining the sales of Shah Deniz Phase II gas to Turkey based on the principle that BOTAS will buy 4 bcm and "other companies" will buy another 4 for the Turkish market. This is an important compromise from the Turkish side. The mention of "other companies" means Yildiz may have agreed to SOCAR's demand to market gas directly into Turkey (although perhaps in a joint venture with state-owned monopoly oil and gas company BOTAS). In an important sense, Yildiz may be moving Turkey's gas market toward liberalization, a controversial move and one that bucks the interests of state monopolist BOTAS.

19. (SBU) The U.S. is not a commercial partner in developing Caspian gas or transiting it to world markets. These are decisions that will be made by the consortia developing and marketing their gas. The U.S. does not favor one pipeline

ANKARA 00000761 003 OF 004

route or another.

Nabucco IGA

110. (C) Turkey's credibility is on the line. Turkey has been engaged in discussions with the EU Commission, Nabucco partner countries and Nabucco private company backers for over a year. All parties have indicated a willingness to sign the Intergovernmental Agreement (IGA) on Nabucco at the end of June. The IGA would set the legal and regulatory framework and the transit terms for the pipeline. Turkey is balking. At the 11th hour, Turkey is raising ideas, including reviving the proposal to buy 15% of gas transiting Turkey, that have long been rejected by all the partners. Additionally, Turkey has come out against including Iraqi gas in Nabucco. This is extremely frustrating. We need to understand what is driving Turkey's insecurity. Is it a new Minister unwilling to take an important decision so early in his tenure? Is it the fear that Azeri and Iraq gas could be transported across Turkey without Turkey having access to it? Is it the desire of Turkey to buy as much new gas on the market to further its own claims to be an energy hub?

111. (C) We have heard from many private companies that the

window of opportunity to develop Nabucco is closing. Private companies are considering alternative routes to bring Caspian gas to Europe, either via the Black Sea or via Russia. If Turkey drives too hard a bargain, it may lose out on an opportunity to get more gas for itself and to develop a stronger partnership with Europe. There appear to be multiple Turkish motivations/strategies at work. At least some within the GOT appear to be convinced that Turkey,s geography is essential and assume that companies will have to agree to their terms because there are no viable alternative ways for Caspian or Iraqi gas to reach Europe. Others appear to be trying to create a natural gas trading hub in Turkey, and are not satisfied with Turkey being a "mere" transit country. Still others see the Nabucco project as a card to play (or withhold) in Turkey,s European Union accession process. The EU,s failure to open the Energy Chapter of the accession talks even though Turkey has met the preconditions perpetuates mistrust and tit-for-tat diplomacy.

Blue Stream II

¶12. (C) Readouts from MFA, press coverage and other contacts indicate that Turkey is expanding its energy cooperation with Russia. This cooperation is multifaceted and could include renewal of natural gas contract for the West Line (a 6 bcm/a pipeline through Bulgaria), Russian support for the construction of Turkey's north-south oil pipeline (Samsun-Ceyhan), a business deal for the Prime Minister's friend Ahmet Calik to build Blue Stream II (BS II), and a contract for a Russian-led consortium to build Turkey's first civilian nuclear power plant. All of these are still in the negotiation phase. For our Caspian strategy, BS II is the most concerning. Turkey has told us BS II will be part of a North-South gas corridor and could be extended to Israel as part of a "peace pipeline." Industry analysts say such a pipeline scheme does not make economic sense. If BS II gas enters an East-West corridor in large volumes, it could crowd out Caspian and Central Asian gas, leaving that gas without access to western markets.

Working together in Iraq

¶13. (C) U.S. and Turkey share the same strategic goal of a stable and unified Iraq. The U.S. should coordinate with the GOT to send the same messages to Baghdad about the importance of a new legal and regulatory framework for the development of hydrocarbons in Iraq. As is well known, Iraq has vast oil and gas resources. In order to develop these for the benefit of all the Iraqi people, new legislation must be passed to ensure hydrocarbon revenues are shared among all regions. Turkey has long requested the support of the U.S. for a gas export pipeline from Iraq. Such a pipeline would help Iraq strengthen and deepen its trade and commercial relations with Turkey, Europe and other world markets. These are important goals which we support. Iraqi gas cannot, however, be a zero-sum game.

¶14. (C) A tougher question is whether the USG supports or opposes the export of KRG oil with central government approval, but before a hydrocarbons law is passed. Norwegian oil company DNO recently told us that they do not themselves export the oil, but rather sell it to the Iraqi state oil company SOMO, which exports it via the Kirkuk-Yumurtalik pipeline into Turkey. The GOT may view this project as

ANKARA 00000761 004 OF 004

precedent for other projects. The USG position is still under review.

U.S. support for Turkey's energy security

¶15. (SBU) On April 4, former Energy Minister Guler and Acting TDA Director Leocadia Zak signed a memorandum of

understanding on cooperation on energy efficiency, renewable energy technology and clean coal technology. Currently, there are four projects in various stages of development:

--USTDA is negotiating with Argonne National Lab to carry out training on energy planning and modeling software;

--In September, USTDA will host a visit of Turkish officials to the US for meetings with government and private sector officials on energy efficiency;

--TDA will provide a grant for a feasibility study on coal gasification;

--TDA will provide technical assistance on solar power.

Oil and gas exploration off-shore Cyprus

¶16. (SBU) The U.S. firm Noble Energy will soon begin exploration activities in a block southwest of Cyprus. Although, Turkey, Cyprus and neighboring countries have not yet reached an agreement to demarcate their exclusive economic zones (EEZ), this block is located between Cyprus and Egypt and cannot realistically be claimed as part of Turkey,s EEZ. However, Turkey may still object because the revenues from this project will go to the Republic of Cyprus with no benefits to the Turkish Cypriots. Turkey argues that the Greek Cypriots are not the sole beneficiary of Cyprus, natural resources and that they should not be developed and utilized as such until a comprehensive settlement has been achieved.

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